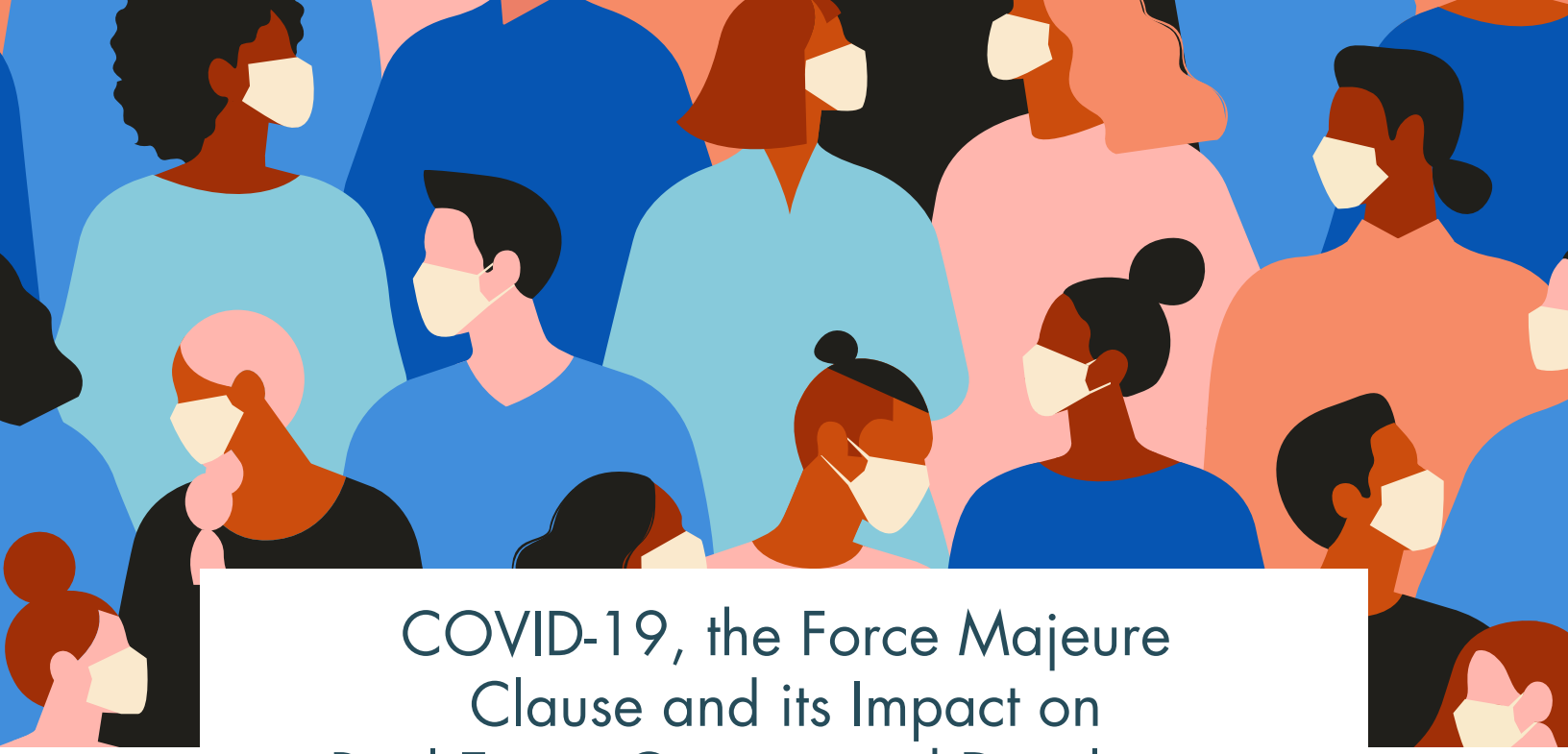

COVID-19, the Force Majeure Clause and its Impact on Real Estate Owners and Developers

Part 1: The Basics

The COVID-19 pandemic and the federal, state and local government restrictions that have followed impact many industries, and perhaps none more so than the retail and restaurant industries. While the impact on retailers, restaurants owners, and their employees is oft-discussed and analyzed, the effect on the landlords, developers and property management firms that support these industries deserves equal attention. In particular, the government-ordered shuttering of non-essential retail businesses and stoppage of non-essential construction has had, and will continue to have, a tremendous impact on the commercial real estate industry. Therefore, it is important to understand the legal rights and obligations of the parties involved. To that end, Orloff, Lowenbach, Stifelman & Siegel, P.A. is launching this multi-part series to shed light on some of the major issues that may confront commercial landlords and developers in today's evolving marketplace.

Part 1 of the series, entitled "The Basics," focuses on force majeure clauses in commercial real estate leases, and whether a tenant can utilize the clause to withhold rent based upon an inability to operate as it once did. Take, for example, this unfortunate, all-too-familiar scenario facing commercial landlords:

> MallCo is the owner and operator of a large retail shopping center containing several commercial, retail tenants, including ShopCo, a "big box" store that is an important anchor to the shopping center. The Federal, state and local governments have issued various restrictions on non-essential business operations effectively closing operations or significantly limiting business traffic, operation hours, shipments and physical access by customers and employees to the premises. As a result, ShopCo informs the landlord that it intends to exercise its rights under the lease's force majeure clause and forego paying rent until the current crisis subsides because it is impossible or impractical for it to continue its operations under these circumstances.

Does the force majeure clause permit ShopCo to do that? The answer, like the current situation, is complicated.

What is a "force majeure clause?"

At the core of this discussion is a provision commonly found in commercial leases known as a force majeure clause. Black's Law Dictionary defines it as a "contractual provision allocating the risk of loss if performance becomes impossible or impracticable, especially as a result of an event or effect that the parties could not have anticipated or controlled."[1] The event or effect is known as a "force majeure" (or literally, "superior force"), and when applicable, the clause excuses certain obligations of the parties under the lease because of the occurrence of that event or circumstance.

Does the COVID-19 pandemic qualify as a "force majeure?"

While every force majeure clause will contain its own terms as to what qualifies, generally the clause will delineate specific extraordinary events such as floods, hurricanes, diseases, riots, strikes, and wars, as well as other events out of the control of the parties, such as governmental restrictions that are suddenly applied. Whether the COVID-19 pandemic qualifies as such an event requires an examination of the specific clause at issue.

Take (and compare) these two samples of force majeure clauses as illustrations of general or broad language (Example 1) and more specific language (Example 2):

> **Example 1:** Landlord and/or tenant shall be excused from performance under this contract if it is prevented from doing so by an act of God (e.g., flood, power failure, etc.), or other unforeseen events or circumstances.

> **Example 2:** Landlord and/or tenant shall be excused for the period of any delay and shall not be deemed in default with respect to the performance of any of the terms, covenants, and conditions of this lease when prevented from so doing by cause or causes beyond the landlord's and/or tenant's control, which shall include, without limitation, all labor disputes, governmental regulations or controls, fire or other casualty, inability to obtain any material, services, acts of God, diseases, or any other cause, whether similar or dissimilar to the foregoing, not within the control of the landlord and/or tenant.

Courts generally will not hesitate to apply a force majeure clause to events specifically delineated in the clause. Thus, clauses like Example 2, which include "diseases" or similar terms, such as "epidemics" or "pandemics," will likely cover COVID-19. Additionally, the inclusion of "governmental regulations or controls" will also likely apply, as the restrictions currently in place are likely covered by such language.[2] However, because force majeure clauses are interpreted narrowly by courts, catch-all language, such as "acts of God," will not likely be construed to its widest extent, but rather, only to events of the same nature or class as those specifically enumerated. Thus, force majeure clauses like Example 1 may not cover the COVID-19 pandemic or the governmental restrictions currently in place, notwithstanding the inclusion of "acts of God," and "unforeseen events or circumstances," as the examples expressly listed in the clause are not of the same nature as the current situation.[3]

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1. *Force Majeure Clause*, Black's Law Dictionary (11th ed. 2019).
2. See Duane Reade v. Stoneybrook Realty, LLC, 63 A.D.3d 433 (N.Y. App. Div. 1st Dep't 2009); see also Facto v. Pantagis, 390 N.J. Super. 227 (App. Div. 2007) (holding that while the force majeure clause was relatively vague, because the event was a power failure and power failure was stated explicitly as an example of an "act of God.")
3. See Route 6 Outparcels, LLC v. Ruby Tuesday, Inc., 88 A.D.3d 1224 (N.Y. App. Div. 3d Dep't 2011) (court holding that economic recession not covered by force majeure clause because it did not explicitly include economic recession, and the vague catch-all parts of the clause could not be read to include economic recession).

If applicable, does the force majeure clause permit a tenant to avoid paying rent?

Just because the force majeure clause applies does not answer the question as to what obligations are actually excused. A force majeure clause only excuses a party's performance if the covered event is one that fundamentally alters the nature of the parties' ongoing relationship. There must be a direct link between the covered event and the inability of the party to perform.[4] Mere economic hardship caused by the force majeure will normally be insufficient to excuse performance.

In connection with the payment of rent, many commercial leases expressly provide that the tenant's monetary obligations, including the payment of rent, are not covered by the force majeure clause, and courts will almost certainly enforce the contract as written.

Even absent an express carve-out for monetary obligations, force majeure clauses generally do not automatically cover the payment of rent, utilities or insurance. While tenants may argue that they should be excused from paying rent because the store is required to be closed, the issue is whether the underlying purpose of the lease was conditioned upon the store being physically open to the public. If not, the tenant's obligation to pay rent may not be excused, particularly where, as here in the New York/New Jersey region, the executive orders do not necessarily preclude the ability for the retailer to handle pick-ups and deliveries and operations may be permitted, albeit in an extremely limited capacity. Put differently, although the retailer is clearly suffering a hardship from the restrictions imposed, those restrictions may not frustrate the underlying purpose of the lease in order to excuse the obligation to pay rent.

In the end, there is no one-size-fits-all answer. Ultimately, whether rent can be excused is heavily dependent on not just the language in the force majeure clause, but also how that language interplays with other clauses in the lease under the attendant facts and applicable law. For example, in leases that involve more explicit interplay between the rent and other provisions such as in a percentage lease where the rent is tied to sales or a share of profits, the tenant may be able to abate some rent where the tenant is unable to operate due to governmental restrictions and, as a result, sales or profits are reduced. Indeed, it can be argued that the very nature of a percentage lease is designed to allocate some of the risk to both sides enabling both landlord and tenant to reap the rewards of strong sales, while also sharing the costs of poor performance.

Additionally, while a tenant may not be able to avoid paying rent, it may be able to avoid other bases for default under the lease, such as where the lease includes a continuous operation covenant. Such a covenant normally requires a tenant not just to pay rent, but to continuously operate, even at a loss, during the term of a lease. Nevertheless, a force majeure clause may well excuse the tenant's obligation. For example, if ShopCo is subject to a continuous operation covenant, it is required to maintain store operations during normal business hours for the entire lease term, and if it does not, the landlord can seek specific performance. However, if governmental restrictions forbid ShopCo from having customers in the store, enforcement of the continuous operation covenant may well be denied pursuant to an applicable force majeure clause.[5]

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4. For example, in Burnside 711, LLC v. Nassau Regional Off-Track Betting Corp., 67 A.D.3d 718 (N.Y. App. Div. 2d Dep't. 2009), the tenant's obligation to pay rent was eliminated because the lease stated the purpose was solely to oazperate a betting parlor and the town changed its regulations to prohibit that specific use for that property. But see Sage Realty Corp. v. Jugobanka, D.D., 1998 WL 702272, at *5 (S.D.N.Y. Oct. 8, 1998), where the court found that notwithstanding governmental restrictions, tenant's primary obligation was to pay rent, which it was not prevented from doing under the restrictions.
5. However, consider the scenario where a restaurant determines it would be economically advantageous to close altogether instead of switching to take-out and delivery, as the current governmental restrictions permit. Unlike ShopCo, the restaurant may still be subject to the continuous operation covenant, as certain restaurant operations are still expressly permitted.

Finally, if a tenant is unsuccessful in enforcing the force majeure clause—or if there is no force majeure clause—other options may still be potentially available to excuse performance, such as the common law defenses of impossibility, impracticability and frustration of purpose. These common law doctrines are different versions of essentially the same concept: performance is excused because the occurrence of an event has made it impossible or impractical to perform under the contract, or has completely frustrated the underlying purpose of the contract. These doctrines rarely excuse the payment of monetary obligations, as mere economic hardship is not sufficient. Furthermore, these doctrines are secondary to any express provisions of a contract, and thus, if the contract provides that the payment of rent is not covered by the force majeure clause, these doctrines will also not excuse the payment of rent.

Practical Steps

As should be apparent at this point, determining whether a force majeure is applicable and excuses the tenant's obligations under the lease can be fact-sensitive and often complicated. There is no easy answer as to how this current state of affairs due to COVID-19 will impact the legal obligations of landlords and tenants under their leases, but consider the following:

- Review the specific force majeure clause in the lease. Does it expressly exclude the tenant's monetary obligations? Are its terms broad or specific?
- Make sure that the tenant has satisfied any notice requirements in the lease. Notice may be required to be given in writing, delivered in a particular manner, or provided within a specific time period. Courts strictly enforce notice provisions, so tenants must meet the specific notice requirements set forth in the lease, and the failure to give timely or adequate notice may result in a waiver of their rights under the clause.
- Understand the specific basis for the tenant's invocation of the force majeure clause. Is the tenant acting in "good faith" or is it simply looking for an excuse or pretext not to pay rent? Context is crucial.
- Communicate early and often and make sure communications are in writing. Communication with a tenant can help quash problems before they arise and allow the parties to work together in these difficult times. Sometimes the best solution is a practical business solution. However, having those communications in writing also creates a record that may be important should litigation become necessary.
- Don't hesitate to ask questions or seek guidance. Each situation may be different or distinguishable so consult with legal counsel, as necessary.

Ultimately, determining whether the force majeure clause applies, if its terms have been satisfied or has it been properly invoked depends upon the particularized facts and applicable law. Accordingly, the thoughts, suggestions and opinions expressed in this alert are not intended to be relied upon as legal advice or to create an attorney-client relationship with those to whom it is sent. Rather, this alert is being provided for informational purposes only and is not a substitute for a legal consultation based upon a thorough review of the specific facts under the law that may be applicable to your particular situation.

To that end, should you wish to discuss these or other issues or concerns as they affect your business, please feel free to contact Marc Singer and Xiao Sun by phone 973-622-6200, or e-mail mcs@olss.com and xs@olss.com or visit the OLSS website, at olss.com to review their practice areas and professional profiles for further information.